Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT® FEBRUARY/MARCH 2018

LexisNexis

Pratt's Journal of Bankruptcy Law

VOLUME 14 NUMBER 2 FEB./MAR. 2018

LexisNexis®

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:
Kent K. B. Hanson, J.D., at 415-908-3207
Email: ..... kent.hanson@lexisnexis.com
Outside the United States and Canada, please call . . . . . (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:
Customer Services Department at . . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . . (518) 487-3385
Fax Number . . . . . (800) 828-8341
Customer Service Website . . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call
Your account manager or . . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . . (937) 247-0293

Library of Congress Card Number: 80-68780
ISBN: 978-0-7698-7846-1 (print)
ISBN: 978-0-7698-7988-8 (eBook)
ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (2014)

An A.S. Pratt® Publication

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW BENDER

(2018–Pub.4789)

Editor-in-Chief, Editor & Board of Editors

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by Matthew Bender & Company, Inc.

Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, No. 18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 718.224.2258. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, Attn: Customer Service, 9443 Springboro Pike, Miamisburg, OH 45342-9907.

Circuit Dissonance: Does Retention of Collateral Seized Prepetition Violate the Automatic Stay?

By Peter C. Blain*

While there is no dispute regarding the prohibition of acts to repossess collateral after the commencement of a case, what about a secured creditor's retention of property lawfully seized pre-bankruptcy? The author of this article discusses the circuit split that makes this issue ripe for resolution by the U.S. Supreme Court, whose decisions on related issues appear not to be particularly helpful.

The automatic stay set forth in Section 362(a)(3) of the U.S. Bankruptcy Code[1] is one of the most fundamental protections facilitating a debtor's breathing spell at the commencement of a case. Code Section 362(a)(3) prohibits "any act to obtain possession of property of the estate or property from the estate or to exercise control over property of the estate." Prior to 1984, the provision only prohibited any act to obtain possession of property of the bankruptcy estate. When Congress passed the Bankruptcy Amendments and Federal Judgeship Act of 1984, without explanation, the section was amended to add as prohibited conduct acts to "exercise control over property of the estate."[2]

While there is no dispute regarding the prohibition of acts to repossess collateral after the commencement of a case, what about a secured creditor's retention of property lawfully seized pre-bankruptcy? Failure to turn over essential collateral to a corporate or individual debtor in the first days of a case could cripple an individual or entity struggling to reorganize. However, whether a creditor who refuses to return property seized prepetition violates the stay depends upon the circuit in which the case is pending. The conflict among the circuits seems to come down to a battle of Code sections and dictionary definitions. The circuit split makes this issue ripe for resolution by the U.S. Supreme Court, whose decisions on related issues appear not to be particularly helpful.

---

* Peter C. Blain is a shareholder at Reinhart Boerner Van Deuren s.c. and chair of the firm's Business Reorganization Practice, representing diverse parties in complex distress transactions both in and outside of bankruptcy proceedings, including lenders, debtors, trustees, committees, and other creditors. He may be contacted at pblain@reinhartlaw.com.

1 11 U.S.C. §§ 101–1532 (the "Code").

2 Pub. L. No. 98–353 (1984).

RETAINING SEIZED PROPERTY VIOLATES THE STAY—THE MAJORITY VIEW

Illustrative of the decisions comprising the majority rule is *Thompson v. General Motors Acceptance Corp.*[3] In *Thompson*, the U.S. Court of Appeals for the Seventh Circuit dealt with the prepetition seizure of an automobile in a Chapter 13 case, and the secured creditor's refusal to turn the car over to the debtor post petition. The court rejected the secured creditor's argument that the Code only restricted obtaining possession of property, not passively continuing to possess it:

> This interpretation is at odds with the plain meaning of "exercising control." Webster's Dictionary defines "control" as, among other things, "to exercise restraining or directing influence over" or "to have power over." Merriam-Webster Collegiate Dictionary (11th Ed. 2003). Holding onto an asset, refusing to return it, and otherwise prohibiting a debtor's beneficial use of an asset all fit within this definition, as well within the commonsense meaning of the word.
>
> Moreover, to hold that "exercising control" over an asset encompasses only selling or otherwise destroying the asset would not be logical given the central purpose of reorganization bankruptcy. The primary goal of reorganization bankruptcy is to group *all* of the debtor's property in his estate such that he may rehabilitate his credit and pay off his debtors; this necessarily extends to all property, even property lawfully seized.[4]

The court further reasoned that the 1984 amendment to add control of property of estate as a prohibited act "evinces [Congress's] intent to expand the prohibited conduct beyond mere possession."[5]

The court also found support in Code Section 542(a), which compels a creditor to turn over seized property. "This provision states that a creditor in possession of an asset belonging to the bankruptcy estate '*shall deliver* to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.'"[6] The court relied heavily on the U.S. Supreme Court's 1983 decision of *United States v.*

---

[3] *Thompson v. General Motors Acceptance Corp.,* 566 F.3d 699 (7th Cir. 2009).

[4] *Id.* at 702.

[5] *Id.*

[6] *Id.* at 704.

Whiting Pools, Inc.,[7] where the court held that Code Section 542(a) required the Internal Revenue Service to turnover to the Chapter 11 debtor operating assets seized prepetition. Significantly, the *Thompson* court read the *Whiting Pools* decision to find that Code Section 542(a) was self-executing and that the secured creditor must turn over the property of the estate rather than implementing the non-bankruptcy remedy of possession.[8] The court submitted that there were three reasons to put the onus on the secured creditor, rather than the debtor, to seek judicial relief:

> First, the purpose of reorganization bankruptcy, be it corporate or personal, is to allow the debtor to regain his financial foothold and repay his creditors . . . . Second, allowing the creditor to maintain possession of the asset until it subjectively feels that adequate protection is in place, or until the debtor moves for the asset's return, unfairly tips the bargaining power in favor of the creditor . . . . Third, requiring the debtor, rather than the creditor, to bear the costs of seeking court relief hurts not only the debtor but all of the debtor's other creditors by virtue of decreasing the value of the bankruptcy estate.[9]

The court rebuffed GMAC's argument that the asset which it is required to turn over may lose substantially all of its value before the bankruptcy court rules on the creditor's adequate protection motion. "Although this is theoretically possible, The Bankruptcy Code has a procedure in place to combat such a problem—the emergency motion."[10] The Seventh Circuit's decision and rationale comports with decisions rendered by the U.S. Courts of Appeals for the Second,[11] the Ninth,[12] and the Eighth Circuits.[13]

---

[7] *United States v. Whiting Pools, Inc.,* 462 U.S. 198, 103 S. Ct. 2309, 76 L. Ed. 2d 515 (1983).

[8] *Thompson,* 566 F.3d at 706.

[9] *Id.* at 706–707.

[10] *Id.* at 707.

[11] *Weber v. SEFCU (In re Weber),* 719 F.3d 72, 79 (2d Cir. 2013) (citing Collier on Bankruptcy § 542.02 (16th ed. 2012), for the proposition that Code Section 542 is self-executing; and Webster's New World College Dictionary (4th ed. 2002), which defines "control" as exercising authority, direction or command over).

[12] *Cal. Emp't. Dev. Dep't. v. Taxel (In re Del Mission Ltd.),* 98 F.3d. 1147, 1151 (9th Cir. 1996) ("The onus to return estate property is on the possessor; it does not fall on the debtor to pursue the possessor.").

[13] *Knaus v. Concordia Lumber Co., (In re Knaus),* 889 F.2d 773, 775 (8th Cir. 1989) (the duty to turn over property is not contingent upon any order of the bankruptcy court and failure

RETAINING SEIZED PROPERTY DOES NOT VIOLATE THE STAY—THE MINORITY VIEW

In February 2017, the U.S. Court of Appeals for the Tenth Circuit in *In re Cowen*,[14] joined the U.S. Court of Appeals for the D.C. Circuit[15] in rejecting the majority view. Jared Cowen was lured under false pretenses by the secured creditor, Bert Dring, to bring his Peterbilt semi-truck to the secured creditor's place of business. When Cowen arrived, Dring jumped into the running vehicle and order Cowen and his young son to leave the premises, which they did after being surrounded five men and Dring threatened them with a can of mace. After Cowen left, Dring sent Cowen a letter giving him 10 days to pay the amounts due. Cowen filed a Chapter 13 within the 10-day cure period and demanded return of the semi, which Dring refused. Dring claimed that he sold the truck before the petition was filed. Cowen moved the bankruptcy court for orders to show cause why Dring should not be held in contempt for violating the stay. The bankruptcy court granted Cowen's motion to turn over the truck. When Dring did not comply, Cowen filed an adversary proceeding for violations of the stay. The bankruptcy court granted judgment to Cowen (finding Dring's contention that the truck was sold prepetition not credible), and the district court affirmed.

The Tenth Circuit noted the majority view regarding the application of Code Section 362(a)(3) to property seized prepetition. It said, however, that the "Defendants disagree with this interpretation of § 362(a)(3) and we agree with the Defendants."[16] The majority rule, said the court, seemed to be driven by "practical considerations" and "policy considerations" rather than a faithful adherence to the text.[17] Parsing the text of Code Section 362(a)(3), the court noted that section prohibits "'any act to obtain possession of property' or 'any act to exercise control over property.' 'Act', in turn, commonly means to 'take action' or 'do something.' *New Oxford American Dictionary* 15 (3d ed. 2010) (primary definition of 'act')."[18]

Suggesting that the majority rule puts too much stock in the legislative history of Code Section 362(a)(3), the court concluded that the section only

---

to turn over the property is an exercise of control in violation of the automatic stay).

[14] *WD Equip., LLC v. Cowen (In re Cowen),* 849 F.3d 943 (10th Cir. 2017).

[15] *United States v. Inslaw, Inc.,* 932 F.2d 1467 (D.C. Cir. 1991).

[16] *In re Cowen,* 849 F.3d at 948.

[17] *Id.* at 948–49.

[18] *Id.* at 949.

stays entities from *doing* something to exercise control over property of estate (such as selling it). It does not cover passively holding on to property of the estate, nor does the section impose an affirmative obligation to turnover property to the estate.[19] Acknowledging that Code Section 542 as read by the *Thompson* line of cases seems to compel the turnover of property, and that Code Section 362(a)(3) provides the remedy for the failure to do so, the court does not find this argument supported by the statute's text or its legislative history.[20] The court refused to decide whether Code Section 542 is self-executing, but proffered that there was no textual link between Code Sections 542 and 362(a)(3). Moreover, "bankruptcy courts do not need § 362 to enforce the turnover of property of estate. Bankruptcy courts have 'broad equitable powers' under 11 U.S.C. § 105(a) . . . and can provide equitable relief as 'necessary or appropriate to carry out the provisions of' § 542(a)."[21]

THE SUPREME COURT DECISIONS DON'T SEEM TO HELP

In its opinion, the *Cowen* court cited Professor Ralph Brubaker's article[22] which supports the minority view that the drafters meant to distinguish prohibited *acts* of "control" added in 1994 from *acts* to obtain possession of estate property prohibited pre-amendment.[23] According to Professor Brubaker, passively holding property cannot be a prohibited "act."[24] Brubaker also argues that compelling immediate turnover, without providing the secured creditor with adequate protection, would terminate possessory liens (thereby precluding adequate protection), or put at risk property surrendered to the debtor which the debtor has not insured.[25] Notwithstanding the clear directive in Code Section 542(a) that a party in possession of property of the estate *shall* deliver it to the trustee, and the *Whiting Pools* decision relied upon by the *Thompson* line of cases, Brubaker argues that Code Section 542(a) is not self-executing,[26] and must give way to a secured creditor's right to adequate protection.[27]

---

[19] *Id.*

[20] *Id.* at 950.

[21] *Id.* (citation omitted).

[22] Ralph Brubaker, *Turnover, Adequate Protection, and the Automatic Stay (Part II): Who is "Exercising Control" Over What?*, Bank. Law Letter, Sept. 2013, at 1 (hereinafter "Brubaker").

[23] *In re Cowen*, 849 F.3d at 949.

[24] Brubaker, *supra* note 22, at 3.

[25] *Id.* at 7.

[26] *Id.* at 4.

[27] *Id.* at 7.

For support Brubaker looks to *Citizens Bank of Maryland v. Strumpf*,[28] decided by the Supreme Court in 1994. *Strumpf* involved a bank with a right of offset which instead placed an "administrative hold" on a debtor's bank account. The U.S. Court of Appeals for the Fourth Circuit ruled that placing an administrative hold on an account constituted a setoff that violated the automatic stay. The Supreme Court disagreed, finding that Code Section 542(b) excused a party with a right of offset from paying the funds owed to the trustee.[29] The Supreme Court went on to observe that the bank did not exercise dominion over property of the estate because a bank account constitutes a promise to pay the debtor/depositor, not property belonging to it. Brubaker appears to argue that just as the application of the automatic stay must bow to Code Section 542(b) excusing turnover in the face of a right of setoff, it must also yield to a secured creditor's right to adequate protection where the only "act" at issue is passive possession garnered prepetition. However, unlike Code Section 542(b) which specifically excuses a party with a right of offset from turning over money owed, there is no exception for secured creditors in possession of seized property who may have a right to adequate protection.

CONCLUSION

The issue remains muddled. The majority view is grounded upon the policy of facilitating reorganizations, the mandatory directive in Code Section 542(a) and the definition of "control" as used in Code Section 362(a)(3) to find that the duty to deliver property seized prepetition to the estate is self-executing and the burden is on the secured creditor to protect its position. The minority view points to the secured creditor's entitlement to adequate protection and the definition of "acts" to excuse the turnover of property passively held, putting the burden of retrieving the property on the debtor. The existing Supreme Court precedent doesn't help all that much. Until the Supreme Court resolves the circuit split, secured creditors, particularly those that do business nationwide, need to be mindful that the consequences of their actions will depend upon where they are.

---

[28] *Citizens Bank of Md. v. Strumpf,* 516 U.S. 16, 116 S. Ct. 286, 133 L. Ed. 2d 258 (1994).

[29] *Id.* at 289.